

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 04 TAIPEI 003850

SIPDIS

DEPT FOR EAP/TC AND EB/TRA/OTP  
DEPT PLEASE PASS AIT/W

E.O. 12958: DECL: 12/03/2014

TAGS: [FAIR](#) [ECON](#) [PREL](#) [ETRD](#) [EINV](#) [TW](#) [CH](#)

SUBJECT: CROSS-STRAIT AVIATION - THE GOLDEN LINK STILL OUT  
OF REACH

REF: A. AIT TAIPEI 2320

1B. AIT TAIPEI 3406

Classified By: AIT Direct Douglas H. Paal, Reason 1.5 D

Summary

-----

11. (C) Direct air transportation is the last area where the "three-links" have not been realized in either name or substance. Direct air links would cut passenger travel time by up to an hour and a half; ticket prices by more than 25 percent; and airfreight costs by 20 percent or more. Taiwan's high-tech industries would benefit from reduced air transportation costs that would likely increase cross-Straits trade. Less expensive cross-Straits air transportation could also dampen the rate of increase in the flow of investment from Taiwan to the PRC. Taiwan airlines have already developed connection arrangements akin to code-shares with PRC airlines in order to compete with Hong Kong and Macau carriers across the Straits. However, Taiwan carriers are also ready to compete with PRC firms on direct cross-Straits routes. U.S. passenger airlines are not interested in providing cross-Straits service, but some U.S. air cargo firms, are concerned that if direct air links were to be established, foreign firms would be excluded from the new routes. Direct air links would contribute to growth on both sides of the Straits, but politics continue to get in the way. End Summary.

12. (U) When originally proposed in 1979, the "three-links" to be established between Taiwan and the PRC consisted of direct postal and telecommunications services, cross-Straits commerce, and direct transportation. The first two links have been effectively realized. Over one million pieces of mail and about 50 million phone calls cross the Taiwan Straits every month. The PRC accounted for 70 percent of Taiwan's outward investment and 25 percent of its exports in the first half of this year and has been Taiwan's largest trade partner for two years. In transportation, various methods of cross-Straits sea freight have emerged to keep costs low despite the absence of full direct shipping (reported ref B). The last and missing link is air transportation.

Passenger Aviation ) Inconvenient and Expensive

-----

13. (U) Most cross-Straits air travelers pass through Hong Kong and Macau, but airlines have also tapped other airports to handle cross-Straits air traffic. Every week there are 444 scheduled flights between Taiwan and Hong Kong (counting both outbound and inbound). There are 336 scheduled flights between Taiwan and Macau. Some cross-Straits traffic also passes through Okinawa, Japan, and Cheju, South Korea, with 28 and 7 scheduled weekly flights. According to Ministry of Transportation and Communications (MOTC) statistics, more than 617,000 passengers flew between Taiwan and Hong Kong in September 2004, 195,000 between Taiwan and Macau. About 15,000 passengers flew between Taiwan and Okinawa. MOTC did not release data for Cheju. Most passengers flying to Hong Kong and Macau proceed on to airports in the PRC. Eva Air (EVA) currently estimates that 60 percent of Hong Kong passengers and 80 percent of Macau passengers continue onward to airports in the PRC. The percentage of travelers to Okinawa and Cheju who are ultimately bound for PRC airports is probably even higher.

14. (C) Air travel on the popular route between Taipei and Shanghai generally costs between NT\$ 14,000 and NT\$ 18,000 (USD 435 to USD 560) for a round trip ticket. Far Eastern and China Eastern Airlines offers a much cheaper fare through Cheju of about NT\$ 10,000 (about USD 310), but that fare is the exception. It is difficult to estimate precisely how much cheaper the fares would be on direct flights. Joseph Lee, Manager of the International Affairs Department at Eva Air, told AIT/T that direct air links would probably cut NT\$ 5,000 to NT\$ 7,000 (USD 155 to USD 215) from the total cost of a Taipei-Shanghai round trip ticket, or somewhere between 25 and 50 percent of the total ticket price. Total travel time is generally about five and a half hours. Airlines agree that direct flights would cut about one and a half

hours off the total travel time.

#### Air Cargo ) Important Factor in Cross-Strait Trade

15. (C) A high volume of air cargo crosses the Taiwan Strait, playing an important role in cross-Strait economic trade. In addition to cargo carried on passenger flights, Taiwan, Hong Kong, and Macau airlines conduct a total of 86 weekly all cargo flights between Taiwan and Hong Kong or Macau. In 2003, Taiwan exported 94,000 MT of goods to Mainland China by air via Hong Kong and Macau. During the same period it imported 66,000 MT from the Mainland by air. EVA estimates that 35 percent of air cargo shipped to Hong Kong and 30 percent of cargo shipped to Macau is ultimately bound for the PRC.

16. (C) The impact direct flights would have on the cost of cross-Strait air cargo varies by the type of service. Door-to-door express delivery services offered by firms like Federal Express, DHL and UPS differ in cost structure from services offered by freight forwarding firms or smaller courier services. Nick Chen, Director of Operations for DHL Taiwan, estimated that direct flights would cut the cost of DHL's cross-Strait express delivery service by approximately 20 percent. The savings on air cargo arranged by freight forwarders that do not generally provide door-to-door service would be higher.

#### Impact ) More Trade, Possibly Less Investment

17. (U) Lower air transportation costs from direct aviation links would stimulate cross-Strait trade, particularly for Taiwan's high-tech industries. MOTC statistics show that Taiwan's electronic goods manufacturers rely heavily on air transportation. According to the most recent data, approximately 15 percent by weight of Taiwan's electronics exports to Mainland China are shipped by air. Electronics goods accounted for almost 58 percent by weight of Taiwan exports shipped to Mainland China by air and about 44 percent of imports.

18. (C) Less expensive, more efficient cross-Strait transportation might also mitigate the rate at which Taiwan investment in the PRC is increasing. If it's cheaper and easier to move goods from Taiwan to China, there may be less economic pressure to move manufacturing operations to the Mainland. Jason Chen, Deputy Spokesman for Taiwan laptop computer manufacturer Quanta, told AIT/T that Quanta could assemble its laptops in either Taiwan or the Mainland, but felt forced to move its manufacturing facilities to the PRC because most of its suppliers had already moved. Inexpensive and reliable air cargo transportation would increase the incentive for Taiwan firms to maintain the manufacture of capital and technology-intensive components in Taiwan, regardless of the location of input manufacturers or final assembly facilities. Overall, Taiwan firms will continue investing heavily in the Mainland regardless of the status of aviation links. However, the flow may be slightly slower with direct air transportation.

19. (U) Reduced air transportation costs would also benefit Taiwan firms that already have invested in the Mainland. Lower airfares would cut costs for managers that live in Taiwan and fly to the Mainland regularly to oversee investments. Some managers, who currently reside in the Mainland due to the inconvenience and high cost of air transportation, might even decide to return to Taiwan as their base of operations. Similarly, multinational firms considering abandoning Taiwan as their headquarters for greater China or East Asia would be more inclined to continue managing regional operations from Taiwan.

#### Impact ) Airline Industry Competition and Exclusion

110. (U) Taiwan airlines have already taken measures to help them compete with Hong Kong and Macau airlines, which can offer service across the Strait and onward connections to PRC destinations. China Airlines (CAL), EVA, Far Eastern Air Transport (FAT) and Trans Asia all have representative offices in Shanghai and Beijing. EVA also has offices in Guangzhou and Xiamen. Many carriers also have cooperative agreements with PRC airlines that function like code-shares in everything but name. CAL flights into Okinawa connect to China Eastern Airlines flights to Shanghai. FAT has a similar arrangement with China Eastern for its flights into Cheju. EVA partners with Shanghai Airlines. Taiwan airlines are able to sell tickets on the PRC legs of these connections to their customers in Taiwan and their PRC partners sell tickets on flights into Taiwan to Mainland customers. However, Taiwan law prohibits Taiwan airlines from entering into code-share agreements with PRC airlines, so these arrangements are not identified as code shares.

111. (C) If direct air links are implemented, Taiwan carriers will have to compete with PRC airlines on the lucrative new

cross-Strait routes. Taiwan and PRC authorities will tightly control the routes. EVA's Lee speculated that the Taiwan and PRC would initially open only four PRC airports for Taiwan flights -) Beijing, Guangzhou, Shanghai and Xiamen. The number of airlines permitted to fly each route would also be strictly limited. PRC airlines may benefit from lower labor costs for most operations, but as CAL's General Manager for Strategic Planning Frank Mao pointed out to AIT/T, many of the costs that airlines face -) fuel, equipment, and landing fees -) are the same for all airlines. EVA's Lee told AIT that although cross-Strait routes might reduce the airline's profit margins, they would substantially increase the revenue base. Both CAL and EVA are confident of their ability to compete with PRC airlines on cross-Strait routes. They expect to benefit from Taiwan investors in the PRC who would prefer to fly Taiwan carriers for better service or due to brand loyalty.

12. (U) The establishment of direct aviation links will require negotiation and compromise on the classification of cross-Strait routes that will impact non-PRC and non-Taiwan carriers. The PRC government will insist that cross-Strait routes are domestic ones, while Taiwan will seek to have them classified as international routes. The most likely outcome is a special "cross-Strait" classification or no classification at all. The Hong Kong-Taiwan Aviation Agreement (as reported ref A) does not identify Hong Kong-Taiwan routes as either domestic, international, or otherwise. However, only Taiwan and Hong Kong carriers are permitted to conduct flights. A similar structure for Taiwan-PRC direct air links would exclude U.S. and other foreign carriers.

13. (C) U.S. passenger airlines are not particularly interested in offering cross-Strait service. U.S. airlines service to Taiwan has generally declined over the years. Delta stopped service to Taiwan nine years ago. Northwest eliminated Taipei-Tokyo service on November 1 and now only offers Taipei-Osaka flights. United Airlines Taiwan General Manager Andrea Wu told AIT/T that United would not be interested in conducting PRC-Taiwan flights, but would be interested in taking advantage of direct flights on other carriers to offer better service for United passengers on a "triangular route." She explained that a significant number of United U.S. passengers traveling to Taiwan want to stop in the PRC on the same trip. The typical pattern is a San Francisco-Shanghai-Taipei-San Francisco trip for business travelers from Silicon Valley visiting greater China's technology centers.

14. (C) U.S. cargo carriers would be more concerned about exclusion from cross-Strait routes. A firm like DHL that primarily transports cargo on planes owned by other firms would not be disadvantaged by a cross-Strait direct air link agreement that excludes foreign carriers. However, FedEx, which maintains its own fleet of aircraft, would be negatively affected. Scott Williams, Taiwan Managing Director for FedEx Express, told AIT/T that the impact of such an agreement on FedEx's Taiwan operations would be "huge." FedEx would be forced to use other carriers for cross-Strait traffic in order to compete, a strategy FedEx generally only employs when its own capacity is inadequate to meet demand.

Comment ) Politics in the Way of Growth

15. (C) Taiwan and the PRC have gradually liberalized cross-Strait economic relations in recent years, increasing their economic integration. Establishing direct air links is the single most important step that the two sides could take to facilitate further cross-Strait commerce. More trade and more efficient investment due to direct air transportation would contribute to growth in both the Mainland and Taiwan. However, domestic politics in Taiwan and the PRC still stand in the way. The political environment after Taiwan's December 11 Legislative Yuan elections on both sides of the Strait will determine the potential for progress toward direct air links. End comment.

PAAL